

Technical and Advisory Assistance to the Government of Croatia

Task Order Completion Report

Prepared by Barents Group of KPMG Consulting
Contract No. PCE-1-05-98-00012-00

Executive Summary

Barents Group of KPMG Consulting (hereafter “Barents Group”) was engaged by the United States Agency for International Development to provide technical advisory assistance to the Government of Croatia (GOC). The purpose of the Task Order was to help institute broad based economic and financial sector reforms by addressing a range of constraints to economic growth, offering policy guidance, recommendations for action, and, where appropriate, to design and implement key reform measures in various economic and financial sectors. The Task Order was constructed soon after the change in Government and therefore focused primarily on support institutional capacity building while providing flexibility given the range of potential economic policy and institutional reform areas in which support could be required. For this reason, some tasks identified in the Task Order received less attention than others.

This document highlights the key areas of support and advisory services executed by Barents Group advisors. It is intended to capture main technical areas wherein Barents Group was active and summarize the results of such assistance (in relation to the Task Order benchmarks). The Task Order made no mention of tangible results but instead was crafted to ensure fundamental progress in key areas, with representative benchmarks mapping to the various areas where technical assistance might be employed. It was our understanding that, primarily, support was intended provide initial assistance until USAID and the GOC could refine plans for Long Term assistance in each of the functional areas identified and ensure the preconditions for more targeted and sector-specific objectives to follow. Along these lines and in accordance with technical directives of USAID/Croatia and counterpart requests, delineated benchmarks within each component were also achieved to varying degrees.

Overall, we believe our program was successful in delivering important services on many fronts, which are highlighted in this summary report. A detailed discussion of our assistance is provided in the attached functional area final reports, which were delivered to USAID/Zagreb and counterparts at the conclusion of this Task Order. The overall objectives were met and the benchmarks, for the most part, achieved. Barents Group was pleased to conduct the work and are grateful to USAID/Zagreb, USAID/E&E, and the Government of Croatia for the tremendous support during this dynamic time.

Areas of Support

Within this context, Barents Group provided technical advisory support to the following GOC agencies:

- **Croatian Privatization Fund (CPF)** – strengthening organizational structure and administration; compiling asset inventory and management techniques; training in business planning, valuation modeling, and asset sale marketing; and preparation of CPF assets for sale (due diligence, preparation of information memorandums, enterprise evaluations, and transaction support). Approximately 60% of LOE was devoted to support to the CPF.
- **Croatian National Bank (CNB)** – on-going bank staff training in financial analysis, bank examination procedures, and risk-management; development of an off-site supervision manual; implementation of automated bank analysis reports (UBPR); and development of computerized Early Warning Systems to identify troubled banks and regulated financial institutions. The work with the CNB built on previous efforts under Barents Group provided TA which commenced in 1995. Approximately 20% of LOE was devoted to support to the CNB.

- **Croatian Ministry of Finance (MOF)** – in cooperation with IMF and US Treasury advisors, prepared assessment and work plan for development of the single GOC treasury account for consolidating all government cash, managing budget execution, and extra-budgetary funding; review and preparation of status report on the pilot single treasury account system, remaining work to complete, and obstacles to completion; and analysis and strategy development of comprehensive fiscal reform law that included government cash and debt management, establishing overall budgetary framework processes and approval, and procedures for controlling and managing government arrears and granting government guarantees. In addition, Barents Group assisted the World Bank in the Public Expenditure and Income Review. Work under the PEIR review was submitted directly to the World Bank Croatia mission. Approximately 15 % of Task Order LOE was devoted to support to the MOF.
- **Croatian Ministry of Economy (MOE)** – work towards identification of priority areas of support to the Deputy Prime Minister of Economy and identification of a suitable candidate to serve in a long-term advisory role to the Deputy Prime Minister, Economy. Approximately 5% of LOE was devoted to support to the MOE.

A detailed review of assistance and accomplishments in each of the above functional areas are provided in the attached Functional Area Final Reports. Appendix A presents in table form assistance provided and status of work relative to the Scope of Work and target benchmarks identified in the Task Order. A brief summary of accomplishments follows.

Summary of Accomplishments

Croatian Privatization Fund

Assistance to the Croatian Privatization Fund was divided into two phases. Phase I focused on evaluating the organizational structure and resource needs of the Fund to determine its ability to achieve its mission, recommend operational and administrative improvements, and assist in the implementation of counter-part approved recommendations. Phase II focused on assisting the CPF prepare assets for sale, including enterprise restructuring and divestment options, and execution of the tender process. In addition, targeted training was provided for CPF executives and staff in the areas of business planning, valuation models, human resource organization, and internal controls and financial management. Over the course of the first 46 months, Barents Group analyzed and made recommendations in the following areas:

- Legal framework, including operating agreements, adequacy of authority, scope of activities and requisite skills-sets, independence structure and operating efficiency;
- Organization structure enhancement;
- Business plan preparation;
- Creation of operating budgets;
- Supervisory board roles and responsibilities;
- Ethics policy for employees, general managers, board members and contractors;
- Media and public relations;
- Training needs assessment, design and implementation of programs;
- Comprehensive inventory of assets;
- Consolidation of assets from other government agencies;
- Financial and accounting controls;
- Management of privatization strategies and policies and implementation thereof;
- Asset management policy and procedures;

- Marketing outreach procedures and strategies;
- Legal documentation for transactions;
- Asset valuation and methodologies; and
- Privatization process and strategies;

In Phase I, our efforts centered on assisting the CPF in establishing an efficient and appropriate operating structure. Barents Group advisors emphasized the importance of developing and communicating a detailed business plan which mapped out the work and target dates for achievement. Emphasis was also placed on identifying key skill-sets required and empowering CPF departments to accomplish their tasks. Coupled with the tailored training in the areas denoted above, such assistance and advice better prepared the CPF to carry out its work, despite the political challenges faced in implementing the privatization process.

Phase II of support, commencing in September 2000, turned to policy guidance and transaction support to structure and complete asset and enterprise sales. Assistance thus focused in the following areas:

- Preparation of assets for sale through dis-aggregation and operational restructuring to improve marketability;
- Preparation of assets for sale through verification of legal status, preparation of information memorandums and advising on and/or preparing tenders;
- Assistance in preparing public and investor outreach programs; and
- Designing strategies for and implementation of batch tendering.

During this period, the CPF made strong progress on disposal of minority share positions for a number of Croatian enterprises. 301 ownership shares were placed for sale on the stock exchange and 214 were sold. 97 interests were tendered through batch sales and 35 had either closed or were in closing stages. Barents Group advisors played a strong role in guiding the CPF through these transactions. In addition, the advisory team prepared approximately 125 information memorandums in support of current and future tenders and conducted evaluations for 22 businesses scheduled for privatization.

Croatian National Bank

Assistance to the Croatian National Bank focused on the improvement of off-site bank supervision capabilities and skill-set development. Priority areas for assistance corresponded to Task 2, Financial Sector Restructuring Reform, component 2: Strengthening bank supervision and implementation of an early warning system and bank rating system based on CAMEL. At the request of the CNB, work focused on the following activities:

- Training in bank financial analysis;
- Initial Development of an Offsite Supervision Manual;
- Establishment of automated bank analysis reports (“UBPR”);
- Establishment of computerized basic Early Warning Systems (“EWS”); and
- Targeted training to CNB supervision staff in risk management, foreign exchange, and derivatives

Assistance in these areas had been on-going since 1995, interrupted, however, in 1998 and 1999 as a result of policy disagreements with the Croatian government. Assistance recommenced in March 2000 and, under this Task Order, ended in April 2001. Barents Group advisors

successfully addressed all target priority areas and strong progress was made. At the conclusion of Barents Group assistance to the CNB under this Task Order, the CNB has adopted the principles and procedures for the CAMEL rating system, has developed and implemented standardized bank performance reports (UBPR), made substantial progress in drafting of the Offsite Supervision Manual, and conducted preliminary work towards development and implementation of an Early Warning System. In addition, Barents Group advisors conducted training and workshops focused in the areas of bank financial analysis, Information Technology management and examinations, and derivatives and risk management. Barents Group advisors were confident that the CNB supervision staff were prepared to begin to independently execute quarterly analyses of each bank. Importantly, the advisory team saw evidence of a more dedicated and committed leadership within the Supervision department to address previous short-comings in the supervisory and regulatory activities entrusted to the department. There is growing understanding of the role of banks in private sector development and the link between strengthened bank monitoring and economic growth.

Fiscal Policy Reform

Assistance within the Fiscal Policy area focused on two major reviews. First, a comprehensive review and analysis of current and future unrecorded government liabilities was conducted. Secondly, Barents Group advisors prepared a review and status report on Government plans to establish a single treasury account, which included mapping out basic government accounting processes and a plan to implement a Financial Management Information System. Work in these two areas addressed Task I, Fiscal Policy Reform and subcomponents (1) expenditure planning and administration and (2) budget tracking and execution.

With respect to the first component, review and analysis of unrecorded liabilities, findings revealed that the debt has been incurred by a wide variety of institutional organizations. These include Central government ministries and agencies, extra-budgetary “funds” (Health, Pension, Unemployment, and Water), Banking, and Public enterprises. In addition, the nature of debt instruments and sources, as well as the beneficiary parties, varies greatly. As such, identifying root causes of the problem and options available for resolution are driven by different factors. While there was substantial improvement in driving down accrued payables for goods and services, there remains a sizeable backlog of payments in key, extra budgetary government “Funds”, the most important of which include the Pension Fund and the Health fund. Beyond this, there is also a large backlog related to financial guarantees to Public Enterprises. This debt load has complicated the ability of the Government of Croatia to effectively Privatize many of these Enterprises as it forces the issue of the how to settle the debt. These Enterprises suffer from their own accrued debts as well, compounding the problem. Based on a crude discounted cash flow method, many of these Enterprises, given their debt position, have net present values of negative millions of kuna.

As for the second component under the Fiscal Area, Implementation Status of the Single Treasury Account, work efforts centered mainly on meetings with GOC ministries engaged in the project, U.S. Treasury advisors, and IMF officials. After extensive consultations and review of relevant documentation, the advisors believed that substantial progress with implementation of the Single Treasury Account had been achieved. The key agency staff has been assigned and working toward implementation target dates, SAP advisors were executing their agreed services (which included training a population pool of approximately 160 persons), and the critical features of the State Treasury System, as it was called, had been included. While the advisors made recommendations on certain facets of the implementation plan, these centered more on system features, and the desirability (or lack thereof) to include them. Additionally, it is recognized that

there remains substantial training and education ahead to ensure all affected parties, directly or indirectly, can effectively utilize the system.

Economic Planning and Advisory Support

Assistance under the Macroeconomic components of the Task Order was minimal. Agreement was reached with the USAID Cognizant Technical Officer at the time to focus on identification of a long-term, resident advisor to the Deputy Prime Minister of Economy and new contract executed specific to counterpart needs in the macroeconomic field. Barents Group fielded three candidates and, after preliminary acceptance by USAID, discussions were held in Zagreb with USAID/Croatia officials and Croatian Ministry of Economy staff. While the main intent was to assess the appropriateness of each candidate, there was a good exchange of ideas and recommendations with regard to macroeconomic policy issues and planning. In the end, an advisor was selected agreeable to both USAID and the Ministry of Economy and a separate Task Order awarded.

Conclusion

The attached Functional Areas Final Reports provide in greater detail the work effort for each functional area. We note that, throughout the period of performance, advisor deployments and their respective Terms of Reference were developed in close cooperation with the USAID/CTO, USAID/Zagreb mission staff, and GOC counterpart representatives. We also note that, prior to completion of this Task Order, Barents Group was awarded three Task Orders to continue work in the critical areas of Macroeconomic policy, Fiscal and Public Sector Management, and Bank Supervision.

Appendix A: Summary of Tasks, Bench-Marks, and Assistance Provided

Task 1: Fiscal Policy Reform

Technical assistance will focus on fiscal policy and administrative reform and training, and will include the following areas:

1. Expenditure planning and administration
2. Budget tracking and execution
3. Tax policy
4. Tax administration
5. Pension reform

Tasks	Benchmark	Assistance Provided	Status
Fiscal Reform	A comprehensive fiscal reform law is drafted	Task not fully addressed, although some discussions took place to map out strategy and tasks need to accomplish	No action taken. Identified as continued support needed for follow-on technical assistance
Treasury Reform	A single treasury account is established	Completed full analysis of steps required and developed work plan for accomplishing single treasury account	Significant progress made in identifying current status, future tasks required, and work plan developed.
Public Expenditure Review	A WB public expenditure review is conducted	Barents Group advisor participated on WB PEIR review. Findings submitted to WB Croatia.	WB PEIR review completed with assistance from Barents Group advisors.
Government liabilities	Strategies are developed for three key liability areas: payment arrears, pensioners debt, and government guarantees	Not addressed in full.	Debt position reviewed. Work commenced in follow-on Task Order.
Budget Classification	A standard budgetary classification system by functional and economic classification is developed	Budget classification system analyzed and recommendations made to GOC for implementation through follow-on Task Order.	Key elements of budget classification system
Expenditure analysis and allocation	An expenditure analysis and allocation system is developed that establishes program coverage and outcome goals, cost-efficiency targets, and tracking mechanism for social and infrastructure programs	Analysis completed and findings reported to GOC for follow-on work. Tasks identified for full implementation.	
Transparent Procurement	A framework for transparent procurement actions takes place	Not addressed.	
Public Payroll and Personnel Records	Centralization of the public payroll and government personnel records is designed and automated	Requirements reviewed and submitted to GOC.	
Non-cash transactions	Transition to noncash payments system for government transactions is achieved	Not addressed. Included in follow-on contract award.	
IAS Accounting	Accounting systems consistent with IAS practice is implemented	Not addressed completely. Included in follow-on contract award.	
Budget tracking system	A plan for the computerization of the budget tracking system is developed and implementation begun	Preliminary review and analysis prepared. Focused assistance included in follow-on contract award.	
Tax collections and Administration	Payroll, income, and VAT tax compliance and collections operations are improved	Not addressed. Included in follow-on contract award.	
Pension Improvements	Strategy to improve the pension system's benefit adequacy and administration are developed.	Not addressed under this Task Order.	

Task 2: Financial Sector Restructuring Reform

Strengthening the banking sector to engage in financial intermediation and payments functions will contribute to private sector development. Technical assistance and training will include the following areas:

1. Consolidating GOC assets and inventory management and disposition of such assets
2. Strengthening bank supervision, implementation of an early warning system and bank rating system based on CAMEL.
3. Strengthening policies and procedures for dealing with problem or failed banks.
4. Strengthening the capacity of the Bank Rehabilitation Agency to combine restructuring and privatization of remaining banks under its authority
5. Assessing the deposit insurance system
6. Analyzing risks resulting from relationships between banks and insurance companies, and banks and pension funds; and
7. Assessing the capacity of commercial banks to undertake payments functions

Task	Benchmark	Assistance Provided	Status
Asset Inventory	6 Months: Inventory of GOC assets in the BRA, Privatization, Health, and Pension Funds completed	Review and inventory of GOC assets commenced, primary focus on assets with Croatian Privatization Fund (CPF). Review of all other agencies completed but data insufficient to complete.	At project close, a complete inventory of CPF assets was completed. Ownership evidence completed and streamlined due diligence commenced for approx. 120 companies in the CPF portfolio.
Asset Management Agency and Consolidation	6 Months: Draft legislation to create a new consolidated Asset Management Agency, or provide new authority to one of the current funds that own assets 12 Months: A Consolidated Asset Management Agency is operating	Legal provisions for transfer of assets for management to CPF made. Formal decrees took place and legislation effecting the transfer of management and sales responsibilities completed. Croatian Privatization Fund tasked with interim asset management and eventual disposition. Technical assistance directed primarily to this agency, with operational support, business plan development, and organizational structure provided.	CPF remains the core repository of state assets, their interim management, and eventual disposition.
Early Warning Systems	6 Months: Early warning system in place in the Croatian National Bank, based on new "output" reports. Training to CNB staff in analysis of output reports	Development and design of an early warning system developed. Formal training provided and a Uniform Bank	Preliminary steps taken to launch EWS, including education and IT planning.

	provided.	Performance Report system established. Continued support under follow-on contract.	
Deposit Insurance	6 Months: Assessment of deposit insurance system completed, and recommendations made to the GOC	Not addressed	No support requested in this field.
Payment Functions	6 Months: Assessment of readiness of commercial banks to undertake payments functions completed and recommendations made.	Indirect support provided through work with Croatian National Bank and individual banks.	Targeted payments system assistance should be incorporated in future TA programs.
Bank Privatization	12 Months: Privatization of all banks under BRA authority underway, e.g. investment advisors selected and tenders out	Not addressed	No support requested. Work focused on support to CPF.
Financial Services Risk Analysis	12 Months: Report analyzing risks of connections between banks, insurance companies, and pension funds completed, and recommendations on reducing risks presented to GOC	Not addressed in full. Covered implicitly under follow-on contract award.	

Task 3: Commercial Law Reform

USAID technical officers and GOC counterparts did not request support under this Task Order in the area of Commercial Law Reform. No direct assistance was provided in this area, although legal reviews conducted within the CPF advisory team that looked at privatization law, bankruptcy law and foreign investment law. No training in the administrative and judicial oversight and in the core element of commercial law reform was provided. Support to this effect was included in a follow-on Task Order awarded prior to the expiry of this Task Order.

Task 4: Agricultural Policy and Support

USAID technical officers and GOC counterparts did not request support under this Task Order in the area of Agricultural Policy. No direct assistance was thus provided under this Task Order, although financial and operational reviews were conducted focused on a select number of Agrikombanots through support to the Croatian Privatization Fund. Continued support in this area was included in a follow-on Task Order RFP.

Task 5: Overarching Economic Policy and Administration Support

Barents Group was requested to identify suitable candidates for Senior Advisor to the Deputy Prime Minister, Economy. Candidate CV's were submitted for USAID review and subsequent discussions with most desirable candidates took place. Following this, selected candidates conducted discussions with USAID/Zagreb and with the Office of the Deputy Prime Minister, Government of Croatia. Primary goals of the field interviews were to 1) determine extent of advisors suitability for Senior Level advisory role and 2) determine suitability of individual after interfacing with Deputy Prime Minister, given the trust and strong relationship that must be realized for effective support at this level. USAID, at the recommendation and acceptance of one

proposed advisor, issued a follow-on Task Order specific to Economic Policy and Administration support prior to the expiry of this Task Order.

Task 6: Training and Public Information

Barents Group developed and conducted various training programs within the functional components where technical assistance was mostly provided – support to the Croatian Privatization Fund and the Croatian National Bank. Training and Public Information within the Fiscal Policy Reform and the Economic Policy and Administration were incorporated into the subsequent Task Order awards which narrowed the Scope of Work and Bench Marks to the specific functional area. With respect to assistance provided to the CPF and CNB, training focused in the following areas. A more detailed discussion can be found in the functional areas Final Reports, attached.

- Croatian Privatization Fund:

- HR training needs assessment
- Development of business plans for enterprise managers
- Valuation Modeling for CPF executives
- Ethics Training for CPF staff and executives

- Croatian National Bank:

- Financial review and analysis
- Understanding and interpreting Uniform Bank Performance Report
- Risk Management
- Croatian National Bank Supervision staff training in the United States

List of Advisors

The following section presents in table form the list of advisors engaged under this Task Order and their functional area of support.

Advisor Name	Functional Area	Position
Lori Bittner Yerzyk	Croatian National Bank	Engagement Manager/Bank Supervision
George Patrick Hallenbeck	Croatian Privatization Fund	Chief of Party/Financial Analyst
David Cooke	Croatian Privatization Fund	Strategic Advisor/Financial Analyst
James “J” Hambric, III	Croatian Privatization Fund	Financial Analyst
Mike Rouswell	Croatian Privatization Fund	Training Specialist/Financial Analyst
Michael Weinstein	Croatian Privatization Fund	Enterprise Valuations
John Glover	Croatian Privatization Fund	Privatization Specialist
Bob Byers	Croatian Privatization Fund	Enterprise Restructuring
Iona Kokino	Croatian Privatization Fund	Due Diligence Preparation
Patrick Weide	Croatian Privatization Fund	Enterprise Evaluations/Tourism Sector
Diederik Advocaat	Croatian Privatization Fund	Privatization Specialist
Leslie Matthews Sulenta	Croatian National Bank	Chief of Party/Bank Supervision
Roy Rossman	Croatian National Bank	IT systems – Off-site Supervision
Richard Sticher	Croatian National Bank	IT systems – Off-site Supervision
James J. Giannetto	Croatian National Bank	Off-site supervision
Paul Stroh	Ministry of Finance	Single Treasury System/GOC liabilities
Donald Derman	Ministry of Finance	Single Treasury System/COG liabilities
Phil Thomas	Ministry of Finance	PEIR Review, GOC Budget
David Culpepper	Ministry of Economy	Advisor to Deputy Prime Minister
John Rogers	Ministry of Economy	Macro Economics Specialist
Alan LeBel	Ministry of Economy	Macro Economics Specialist